

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ducheny Analyst: Jeani Brent Bill Number: AB 489
Related Bills: _____ Telephone: 845-3410 Introduced Date: 02/18/1999
Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Unemployment Insurance Taxes and Employment Training Taxes on Tips

SUMMARY

Under the Bank and Corporation Tax Law and the Personal Income Tax Law, this bill would allow employers a tax credit equal to the amount paid or incurred in the taxable or income year for unemployment insurance taxes and employment training taxes on tips.

EFFECTIVE DATE

As a tax levy, this bill would become effective upon enactment. The bill specifies that the tax credits would apply to taxable or income years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Under the Revenue and Taxation Code, existing state law provides various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Under the Unemployment Insurance Code, existing state law generally requires employers to make contributions to the Unemployment Fund based on specified percentages of wages paid to employees. In addition, this code requires employer to make contributions into the Employment Training Fund in the amount of 1% of wages paid to employees.

Under the Unemployment Insurance Code, wages generally are defined as all remuneration payable to an employee for personal services, including commissions and bonuses, and the reasonable cash value of all remuneration payable to an employee in any medium other than cash. However, only the first \$7,000 paid to an individual by an employer during any calendar year is included in the definition of wages. Wages also include all tips that are received while performing services which constitute employment and that are reported to the employer as required.

AB 489 would allow employers a tax credit equal to the amount paid or incurred in the taxable or income year for unemployment insurance taxes and employment training taxes on tips. If the taxpayer could not use the entire credit in the year claimed, the excess credit amount could be carried over for up to 15 years. The taxpayer would be required to reduce that portion of the ordinary and necessary business expense deduction by an amount equal to the amount of the credit attributable to the wages for which the credit was allowed.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input checked="" type="checkbox"/> N	<input type="checkbox"/> OUA	<input type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

4/8/1999

Since this bill does not specify, the general rules in state tax law regarding the division of credits among taxpayers who share in the costs would apply and this credit would not reduce regular tax below tentative minimum tax for the purposes of alternative minimum tax.

Policy Considerations

This bill provides a credit equal to 100% of taxpayer costs, which is unprecedented as a matter of state tax policy.

Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction or depreciation deduction. This new credit would require an adjustment to reduce basis in order to eliminate the double benefit of receiving both the credit and the expense deduction. However, this adjustment would create a state and federal difference, which is contrary to the state's general conformity policy.

This bill provides a credit for costs that are required by law. Typically, credits are authorized as incentives to encourage behavior, not as an offset to mandated costs.

Tax credits generally are enacted with a sunset date to ensure periodic review of their effectiveness by the Legislature. This credit does not contain a sunset date.

Implementation Considerations

Pursuant to a conversation with the author's staff, amendments are provided that would resolve the following implementation concerns. If this bill is amended as proposed, implementing this bill would be accomplished during the department's normal annual update.

- This bill specifically states that the credit would be allowed "for unemployment insurance taxes and employment training taxes on tips." This phrase leaves unclear whether the credit is intended for all unemployment insurance taxes and only those employment training taxes paid on tips, or whether the credit is intended for only taxes paid on tips. The attached amendments would clarify that the credit would be allowed for only taxes paid on tips.
- This bill uses the terms "unemployment insurance taxes" and "employment training taxes." Neither term is defined. The attached amendments would provide definitions by reference to definitions within the Unemployment Insurance Code.

FISCAL IMPACT

Departmental Costs

If the bill is amended as proposed to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

Tax Revenue Estimate

This estimate is based on the assumption that the unemployment insurance taxes and employment training taxes are on the portion of tip income only, not other wages and salaries.

Fiscal Year Cash Flow Effective 1/1/2000 Enactment Assumed After June 30, 1999 \$ Millions		
1999-0	2000-01	2001-02
(Negligible*)	(Minor**)	(Minor**)

* Loss less than \$50,000

** On the order of \$500,000

Revenue Estimate Discussion

The revenue impact for this bill would be determined by those businesses reporting tip income, the amount of tips reported by employees, and the amount of available tax liabilities of qualified employers.

This estimate was developed with the following information. According to the Employment Development Department (EDD), employers are required to pay a certain percentage amount for unemployment insurance taxes and employment training taxes on wages earned up to the first \$7,000 of wages for each employee per calendar year. The percentage amount fluctuates from one business to another. EDD bases the percentage amount on the number of employees, amount of claims filed, and the number of layoffs in any given year. The statewide average for unemployment insurance is approximately 2.6%, or a maximum of \$182 per employee, per year (\$7,000 x 2.6%) and the average employment training taxes is approximately 0.1% on the same \$7,000 of income, or \$70 per year, per employee (\$7,000 x 0.1%).

According to EDD, approximately 200,000 waitresses and waiters work in California. The majority of these individuals make more than \$7,000 per year in wages alone, and most employers would pay the maximum in unemployment insurance taxes and employment training taxes without regard to tip income. If employers pay \$50 in unemployment insurance taxes and employment training taxes on tip income for as many as 5% of these workers ($.05 \times 200,000 = 10,000$), the potential revenue loss would be on the order of \$500,000. The number of additional employees in other occupations that receive significant amounts of "tip" income reported to employers is not expected to be significant. Therefore, the revenue impact is estimated to be minor in any given year.

BOARD POSITION

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill.

Analyst Jeani Brent
Telephone # 845-3410
Attorney Doug Bramhall

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 489
As Introduced February 18, 1999

AMENDMENT 1

On page 2, modify lines 1 through 5, as follows:

taxable year by the taxpayer ~~for unemployment insurance taxes and employment training taxes~~ on tips reported by his or her employees pursuant to Section 13055 of the Unemployment Insurance Code for unemployment insurance taxes and employment training taxes.

(b) For purposes of this section:

(1) "Unemployment insurance taxes" means employer contributions to the Unemployment Fund pursuant to Section 977 of the Unemployment Insurance Code.

(2) "Employment training taxes" means employer contributions to the Employment Training Fund pursuant to Section 976.6 of the Unemployment Insurance Code.

(3) "Tips" has the meaning provided in Section 927 of the Unemployment Insurance Code.

(c) In the case where the credit allowed under this

AMENDMENT 2

On page 2, lines 9, strikeout "(c)" and insert:

(d)

AMENDMENT 3

On page 2, modify lines 20 through 24, as follows:

by the taxpayer ~~for unemployment insurance taxes and employment training taxes~~ on tips reported by its employees pursuant to Section 13055 of the Unemployment Insurance Code for unemployment insurance taxes and employment training taxes.

(b) For purposes of this section:

(1) "Unemployment insurance taxes" means employer contributions to the Unemployment Fund pursuant to Section 977 of the Unemployment Insurance Code.

(2) "Employment training taxes" means employer contributions to the Employment Training Fund pursuant to Section 976.6 of the Unemployment Insurance Code.

(3) "Tips" has the meaning provided in Section 927 of the Unemployment Insurance Code.

(c) In the case where the credit allowed under this

AMENDMENT 4

On page 2, lines 28, strikeout "(c)" and insert:

(d)